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ABSTRACT

In the late 1980s, the Department of Justice began a campaign of prosecuting dairy companies and individuals associated with these companies for colluding on contract bids to supply milk to schools and military installations. Data were derived from: (1) interviews with officials from the Departments of Defense, Agriculture, and Justice; (2) a review of laws, executive orders, and regulations; and (3) historical data on the dairy industry. Findings indicate that the extent to which the milk marketing and price support programs influence milk contract bid-rigging is unclear. Department of Justice officials said that marketing orders and price supports may foster improper collusion, and that the Capper-Volstead Act's exemption of cooperatives from antitrust statutes may complicate prosecution of bid-rigging cases. Recommendations are made to develop a formal, systematic process for sharing information on cooperatives' pricing; suspend or debar individuals and companies convicted of or indicted for bid-rigging; and provide awareness training to school procurement officials. Appendices contain comments from the Departments of Agriculture and Justice, and the General Accounting Office; and a list of major contributors to the report. (LMI)

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United States General Accounting Office

GAO

Report to the Ranking Minority Member, Committee on Agriculture, House of Representatives

October 1992

FOOD ASSISTANCE

School Milk Contract Bid-Rigging

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United States
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Washington, D.C. 20548

Resources, Community, and
Economic Development Division

B-239877

October 16, 1992

The Honorable Tom Coleman
Ranking Minority Member, Committee
on Agriculture
House of Representatives

Dear Mr. Coleman:

In the late 1980s, the Department of Justice began a campaign of prosecuting dairy companies and individuals associated with these companies for colluding on contract bids to supply milk to schools and military installations. As of March 30, 1992, the Department of Justice had conducted investigations in 19 states and had obtained indictments or filed criminal charges against 16 dairies and 35 individuals.

This report responds to your September 30, 1991, request for an examination of bid-rigging on school milk contracts to determine if there are any problems with agricultural laws or their administration that allowed bid-rigging to occur. These laws include those that have established the milk marketing order and price support programs. Under these programs, the U.S. Department of Agriculture (USDA) establishes minimum prices for milk and other dairy products.

In addition, this report also presents information on the possible influence on bid-rigging of the Capper-Volstead Act, which provides agricultural cooperatives with an exemption from antitrust statutes; reasons why milk contract bid-rigging may occur; the obstacles in detecting and prosecuting such activity; and steps that the Department of Justice and USDA could take to help deter milk contract bid-rigging in the future.

Results in Brief

As a result of the milk marketing and price support programs, dairies operate in a market in which local competitors are aware of the minimum market price of one another's products. The extent, if any, to which these programs influence milk contract bid-rigging is unclear. Department of Justice officials told us that (1) marketing orders and price supports may create an environment that can foster improper collusion on milk prices and (2) the Capper-Volstead Act's exemption may make cases involving bid-rigging among cooperatives more difficult to prosecute. Department of Justice officials provided illustrations of bid-rigging tactics used by dairies; however, these officials did not provide and we could not identify any

actual situations in which these programs or the Capper-Volstead exemption had led to improper behavior.

Although both the Department of Justice and USDA have responsibilities for overseeing agricultural cooperatives, there is currently no formal, systematic process or structure in place for sharing information on cooperatives' pricing. Instead, officials have relied on an informal, ad hoc method for sharing information on bid-rigging.

Irresponsible persons or companies may be suspended or debarred (excluded), as appropriate, from participating in federal contracts or federally funded programs if they are indicted for or convicted of bid-rigging. Although the Department of Defense (DOD) has suspended or barred companies and individuals for bid-rigging, as of March 1992, USDA had neither suspended nor debarred any of the 16 dairies or the 35 individuals—including 13 dairies and 28 individuals convicted of milk contract bid-rigging—from participating in federally funded child nutrition programs.

Bid-rigging awareness training of contracting officials has been recognized as an effective way of deterring improper collusion. Such training could be valuable in identifying and deterring bid-rigging nationwide. USDA has provided such training for school procurement authorities in the areas where bid-rigging has been known to occur and has commented in response to this report that it is expanding this training to other jurisdictions.

Background

State and local governments purchase milk from dairies for various child nutrition programs, including the National School Lunch Program, the School Breakfast Program, and the Special Milk Program for Children. The National School Lunch Act of 1946 (P.L. 79-396) and the Child Nutrition Act of 1966 (P.L. 89-642) authorize USDA to reimburse state and local school authorities—under grant agreements—for some or all of the costs of these programs. Reimbursements are based on either the number of meals served or the number of half-pints of milk served. The schools use these funds, as well as state and local funds and moneys collected from students, to purchase food, including milk, for these programs. These purchases are made through either sealed bid or negotiated procurements. USDA's regulations require that these procurements be conducted in a manner that provides for the maximum amount of open and free competition.

In the late 1980s, Florida's Attorney General discovered a pattern of bid-rigging by dairies involving school milk contracts throughout the state. Such bid-rigging has also been identified in other southeastern states and at military installations. As of March 30, 1992, prosecutions of bid-rigging had resulted in the conviction and sentencing of 13 dairies and 28 individuals.

Bid-Rigging Is Prosecuted Under Antitrust Legislation

Federal criminal prosecution of bid-rigging in supplying milk to schools and military installations has been conducted under the Sherman Antitrust Act (15 U.S.C. 1-7), enacted in 1890, which prohibits practices that tend to monopolize or restrain trade. Department of Justice officials told us that incidents of milk contract bid-rigging are attributable to illegal business practices and not deficiencies in the law. These officials stated that antitrust legislation is considered generally adequate to successfully prosecute bid-rigging—as evidenced by the number of dairies and their employees that have been convicted and sentenced.

Officials Believe Agricultural Programs and Laws May Foster Bid-Rigging

Despite their belief that the Sherman Antitrust Act is generally adequate to prosecute bid-rigging, Department of Justice officials said that the federal government's role in establishing prices for milk and other dairy products can create an environment that could facilitate collusion. They also stated that the limited exemption to antitrust statutes provided to agricultural cooperatives under the Capper-Volstead Act of 1922 (7 U.S.C. 291-292) can add to the difficulty of prosecuting bid-rigging among dairy cooperatives in certain specific circumstances.

Officials Believe That the Federal Role in Setting Dairy Prices Could Facilitate Collusion

The objectives of federal dairy policy are to support farmers' prices and incomes, expand consumption, ensure an adequate supply of good-quality milk, and stabilize dairy prices and markets. Federal dairy policy is carried out principally through two programs—the milk marketing order program and the price support program.

The milk marketing order program, created under the Agricultural Marketing Act of 1937, as amended (7 U.S.C. 601-674), is administered by USDA. Under this program, USDA establishes minimum prices for milk used in fluid milk products and other dairy products, such as cheese and butter, within a geographical area, which is called a marketing order area. Companies that buy milk from dairy farmers supplying the marketing order area are then required to pay the farmers at least USDA's minimum

prices for their milk. The orders also specify how the returns from the milk are to be distributed among producers, and the orders lay out the terms and conditions of sales.

Price supports, created by the Agricultural Act of 1949 (7 U.S.C. 1421-1449) and administered by USDA, can also influence the price dairy farmers receive for their milk. Under this program, USDA agrees to buy cheese, butter, and nonfat dry milk at the agency's announced prices. In this way, the program establishes a floor price below which the market price for farmers' milk is unlikely to fall.

The combination of marketing orders and price supports plays a dominant role in determining the market price of milk. According to Department of Justice officials, this price-setting aspect of federal dairy regulation could create a market environment in which collusion is easier. They stated that in contrast to a company operating in a market-oriented economy, in which prices are determined primarily by competition, a dairy operates in a market in which local competitors are aware of the minimum market price; thus, dairies have a reduced incentive to compete for contracts on the basis of price.

Such a market environment, in the opinion of Justice Department officials, may foster collusion between dairies in determining which will bid on specific contracts. For example, dairies may take turns being the low bidder on specific milk contracts—a scheme referred to as bid-rotation. Also, dairies may simply divide the market through a mutual agreement, with some dairies bidding on those contracts that exceed a specific dollar value, leaving smaller contracts to other dairies. The purpose of this tactic is to reduce the number of dairies bidding—in some cases to one—which, in turn, would provide a dairy the opportunity to submit higher bids, and to reap higher profits, than it would if a competitor was also bidding on a contract.

Justice Department officials did not provide any case examples to support their belief that the federal milk-pricing program has led to bid-rigging on milk contracts. Nor did we find any such examples in our prior reviews of milk-pricing programs. However, we did recommend in our March 1988 report on milk marketing orders that steps be taken to gradually decrease the federal role in milk pricing and, instead, rely to a greater extent on market-oriented pricing for the nation's dairy industry.[1] After our report was issued, USDA held hearings on the milk marketing order program and is

[1]Milk Marketing Orders: Options for Change (GAO/RCED-88-9, Mar. 21, 1988).

currently considering changes to it. The Justice Department has recommended the elimination or substantial modification of the program.[2]

Capper-Volstead Act Provides Limited Exemption to Antitrust Statutes

In the late 1800s and early 1900s, independent farms were typically too small and too numerous to deal effectively with the much larger firms supplying, processing, and marketing agricultural commodities. To overcome this imbalance in market power, farmers organized themselves into cooperatives that jointly marketed their products under agreed-upon prices. These efforts, however, had limited success because these cooperatives were prosecuted by the federal government for antitrust violations under the Sherman Antitrust Act of 1890. States also prosecuted cooperatives under state antitrust statutes.

The Clayton Act of 1914 (15 U.S.C. 12-27) provided a limited exemption from these antitrust laws for cooperatives by allowing the organizing of agricultural cooperatives that met certain criteria and by allowing the "carrying out" of their "legitimate objects." Later, in 1922, the Capper-Volstead Act clarified the limited antitrust exemption provided cooperatives by the Clayton Act by specifying what cooperative marketing activities were permissible. The Capper-Volstead Act stated that farmers could "act together in associations . . . in collectively processing, preparing for market, handling and marketing" agricultural products. The act further permitted the associations to have "marketing agencies in common" and allowed them and their members to "make the necessary contracts and agreements" for these purposes. A marketing agency acts as a broker in locating buyers and selling products produced by the members of a cooperative. A marketing agency in common is an agency that represents more than one cooperative.

Section 2 of the Capper-Volstead Act provided for oversight by USDA to ensure that cooperatives do not abuse their exemption. It authorized the Secretary of Agriculture to order cooperatives to cease and desist activities that monopolize or restrain trade to such an extent that the price of an agricultural product is unduly enhanced. Furthermore, a cooperative loses its protection under the act if it fixes prices with a nonexempt organization, such as an independent dairy.[3]

[2]December 11, 1991, letter to the Honorable Tom Coleman, Ranking Minority Member, House Committee on Agriculture, from W. Lee Rawls, Assistant Attorney General, Office of Legislative Affairs, U.S. Department of Justice.

[3]United States v. Borden Co., 308 U.S. 188, 204-205 (1939).

Some concerns have been expressed in the past that the Capper-Volstead Act allows price-fixing to occur beyond the limits envisioned by the legislation and that the act may now be in need of some revision. For example, a January 1977 Department of Justice report found that some dairy cooperatives had used various tactics to achieve and exercise monopolistic market power—the power to raise prices. The report said that the anticompetitive activities of cooperatives have exceeded what the Congress envisioned in 1922 when it passed the Capper-Volstead Act. The Department of Justice suggested that the law be changed to apply specifically to cooperative mergers and that the "marketing agencies in common" provision of the Capper-Volstead Act be defined and limited in scope.

The President's National Commission for the Review of Antitrust Laws and Procedures, established to study selected aspects of antitrust legislation, concluded in its January 1979 report that some cooperatives have the potential to gain monopolistic market power. The Commission recommended that farmers should continue to enjoy the right to form agricultural cooperatives for the joint marketing of their produce, but that the way cooperatives, once formed, are treated by antitrust laws should be similar to the way ordinary business corporations are treated. Specifically, the report said that mergers, marketing agencies in common, and similar arrangements among cooperatives should be allowed only if no substantial lessening of competition results.

In 1989, USDA reported that cooperatives produced about 75 percent of the milk sold at the wholesale level and about 15 percent of the milk sold at the retail level in the United States. While information is not available to show how frequently cooperatives have engaged in price-fixing among themselves and to what extent the Capper-Volstead Act has deterred the prosecution of rigging bids for contracts to supply milk, Department of Justice officials told us that the act may present an additional hurdle in prosecuting cases involving cooperatives. To illustrate, officials pointed to a 1956 decision involving two dairy cooperatives that had been indicted for allegedly conspiring to fix the prices of milk sold to a military installation. According to Department of Justice officials, the Federal District Court for the District of Columbia acquitted the defendants on the basis that their price-fixing was protected under the Capper-Volstead Act because it was an agreement between two agricultural cooperatives.[4] The point these officials were making was that merely showing collusion on prices was not enough to convict cooperatives of illegal activities. In the case of

[4]United States v. Maryland Cooperative Milk Producers, Inc., 145 F. Supp. 151 (D.D.C. 1956).

cooperatives, it would also be necessary to show that the collaboration on prices constituted predatory activity—which would be more difficult to prove.[6] According to Department of Justice officials, the 1956 decision does not apply to price-fixing between independent dairies or between cooperatives and independent dairies.

Coordination Is Informal Between Justice and USDA in Pursuing Bid-Rigging Cases Involving Dairy Cooperatives

Under current legislation, the Department of Justice and USDA have responsibility for overseeing agricultural cooperatives. The Department of Justice is responsible for the administration of the antitrust laws, while USDA is responsible through administrative regulation for the oversight of cooperatives' price-setting permitted under the Capper-Volstead Act's antitrust exemption.

Because of their respective responsibilities and USDA's role in establishing prices in the dairy industry, we believe it is essential that both departments coordinate and share information to enhance their capabilities to detect and successfully pursue illegal price-fixing. The Department of Justice has information that is not available to USDA. The Department of Justice, through its network of offices of U.S. attorneys and contacts with the offices of state attorneys general, is in a position to learn about cooperatives' activities that might involve violations of the Capper-Volstead Act. This resource could enhance USDA's ability in carrying out the agency's statutory responsibilities under the Capper-Volstead Act—to make sure that cooperatives' activities exempted by this act do not unduly enhance prices.

Conversely, USDA is in a position to develop and provide the Department of Justice with information about anticompetitive practices of cooperatives, which is relevant in regulating them under both the Capper-Volstead Act and the antitrust laws. It would seem important for the Department of Justice to know about USDA's pending actions against cooperatives under the Capper-Volstead Act. In any event, if USDA is pursuing a case against cooperatives for violations of the act, sharing this information with the Department of Justice would be wise, given the possibility that Justice could also be pursuing an antitrust case against the cooperatives. However, according to USDA and Department of Justice officials, there is currently no systematic process or structure in place for coordinating or sharing information on a formal basis. Instead, both departments have relied on informal, ad hoc methods for sharing information on bid-rigging.

[6]Fairdale Farms, Inc. v. Yankee Milk, Inc., 715 F.2d 30, 32 (2d Cir. 1983), cert. denied 464 U.S. 1043 (1984).

In commenting on a draft copy of this report, USDA stated that ". . . there is no indication that cooperatives are working together currently in illegal activity." It may be, however, that the absence of indications of illegal activity could reflect inadequate coordination and information sharing between the departments regarding the pricing between cooperatives and not, as suggested by USDA, that improper bid-rigging is not occurring.

USDA Has Not Debarred Dairies for Bid-Rigging

Federal agencies, including USDA, may debar irresponsible persons or companies from participating in federal contracts or federally funded nonprocurement programs such as those under which state and local governments' contract costs are reimbursed by federal agencies. Separate suspension and debarment regulations govern federal procurement and nonprocurement programs. Under the regulations that govern direct federal procurements[6] —as well as the regulations applicable to USDA's nonprocurement programs, such as the School Lunch Program[7] —if a company or individual is convicted of bid-rigging, there is a cause for debarment, which, if imposed, would normally remain in effect for 3 years.

Following the convictions of the 13 dairies and 28 individuals for bid-rigging mentioned above, the Department of Defense (DOD) debarred 3 of the dairies and 21 of the individuals from participating in federal procurements governmentwide. DOD also temporarily suspended the remaining convicted dairies and individuals from participating in federal procurement contracts until it decides whether these parties should be debarred. However, these debarments and suspensions do not automatically prohibit the companies or individuals from participating in programs such as the National School Lunch Program. As indicated earlier, rather than as with a direct procurement between a federal agency and a contractor, federal moneys are provided through the states to local school authorities, which, in turn, combine these funds with moneys from other sources and enter into contracts for various foods, including milk, to serve to students participating in the National School Lunch Program, School Breakfast Program, and Special Milk Program. Federal funds expended in this manner are referred to as nonprocurement expenditures.

For a dairy or individual to be debarred or suspended from participating in the state or local contracts whose costs are reimbursed by the federal government through nonprocurement actions, USDA would have to act separately from DOD. However, as of March 1992, USDA had neither

[6]Federal Acquisition Regulation (FAR) 9.406-4.

[7]7 C.F.R. 3017.305(a)(1) and (2); 3017.320.

debarred nor suspended any of the 16 dairies or the 35 individuals indicted for bid-rigging—including the 13 dairies and 28 individuals convicted. According to Food and Nutrition Service (FNS) officials, who manage the school food programs within USDA, FNS has not developed expertise in such matters. These officials stated that they, unlike their counterparts in DOD, lack a multidisciplined team of knowledgeable investigators and lawyers to suspend those for whom there is adequate evidence that they improperly rigged bids and to debar those convicted. FNS officials said that a department-level decision would have to be made to use investigative and legal resources from other parts of USDA to assist FNS in pursuing suspensions and debarments. In commenting on a draft copy of this report, USDA stated that FNS has developed expertise in suspensions and debarments related to procurements under the Federal Acquisition Regulation and that the agency is in the process of formalizing its infrastructure to handle investigations and proceedings for suspensions and debarments related to nonprocurement programs. USDA also noted that FNS' policy is to refrain from taking a suspension or debarment action when the cause for such action occurred prior to January 30, 1989 (the date that USDA's nonprocurement suspension and debarment regulations were published).

Apart from imposing debarments and suspensions, DOD has negotiated administrative agreements with two of the convicted dairies. These agreements permit the companies to continue to bid on federal procurements but require them to maintain all records of sales to the government, conduct ethics and antitrust training for their employees, report instances of potential and actual misconduct, and cooperate with any investigation DOD would conduct of the dairies' activities. USDA has participated with DOD in negotiating these administrative agreements to ensure that the agreements include requirements applicable to USDA's programs. According to FNS officials, the administrative agreements adequately protect the interests of the federal government and make debarment by USDA unnecessary. Since the two agreements have only recently been completed, it is too early to assess their value in protecting procurement funds.

Bid-Rigging Awareness Training Is Limited

According to USDA, DOD, and Department of Justice officials, training is essential for helping procurement officials recognize bid-rigging. Such training could include examples of the bid-rigging tactics identified by the Department of Justice that are used by dairies to reduce competition or increase their profits. USDA has provided only limited bid-rigging

awareness training for state and local officials in the southeastern United States. This training was initiated by local USDA officials because of the amount of bid-rigging being found in their region.

We discussed with FNS officials the feasibility and value of providing this training to state school procurement officials in other parts of the country. The FNS officials said that state and local procurement officials are in the best position to identify potential bid-rigging because of their involvement in contracting but that without adequate training, procurement officials are ill-equipped to detect bid-rigging activity. These officials said that expanding the training nationwide had merit but that this decision would have to be deferred to higher authorities in the department and would also have to be coordinated with state school lunch authorities. In a draft of this report, we recommended that the Secretary of Agriculture, in consultation with the Attorney General, examine the feasibility of offering bid-rigging awareness training to state and local school procurement officials nationwide. In commenting on the draft report, USDA stated that FNS is expanding bid-rigging awareness training to other jurisdictions and will continue to encourage the state agencies to work with local school officials to ensure their understanding of procurement requirements and of bid-rigging issues. In response to USDA's comments, we deleted the recommendation from this report.

Conclusions

Detecting and prosecuting bid-rigging between companies or individuals is a difficult undertaking. Department of Justice officials believe that detecting and proving bid-rigging in the dairy industry may be made more difficult because of the federal government's role in establishing prices for milk and other dairy products and the limited exemption from antitrust laws afforded dairy cooperatives under the Capper-Volstead Act. However, the extent, if any, to which federal dairy programs or the Capper-Volstead exemption from antitrust statutes for cooperatives influences milk contract bid-rigging is unclear.

Although the Department of Justice and USDA have responsibilities for overseeing agricultural cooperatives, these departments coordinate or share information in pursuing improper bid-rigging by dairy cooperatives on an informal, ad hoc basis. Reliance upon such a method for coordinating actions and sharing information between the departments may permit improper bid-rigging to go undetected. We believe that a more formal, systematic process for coordinating actions and sharing information between the Department of Justice and USDA would enhance

the departments' respective responsibilities under the antitrust laws and the Capper-Volstead Act.

Furthermore, USDA has available an array of methods to deter improper pricing by companies or individuals, including debarment, suspension, and other administrative actions. However, USDA has neither suspended nor debarred dairies either under investigation for milk contract bid-rigging or convicted of it and has only applied administrative remedies in conjunction with the actions of another department.

Bid-rigging awareness training of contracting officials has been recognized as an effective way of deterring improper collusion. Such training could be valuable in identifying and deterring bid-rigging nationwide. USDA has provided such training for school procurement authorities in the areas where bid-rigging has been known to occur and has commented in response to this report that it is expanding this training to other jurisdictions.

Recommendations

To enhance federal capabilities to identify and deter improper bid-rigging between dairy cooperatives, we recommend that the Secretary of Agriculture and the Attorney General develop a systematic process for coordinating and sharing information on dairy cooperatives suspected of illegal bidding on contracts.

With regard to individuals and companies convicted of or indicted for bid-rigging, we recommend that the Secretary of Agriculture, as appropriate, suspend or debar such individuals or companies from participating in school milk contracts or take other appropriate administrative action.

Agency Comments and Our Evaluation

We provided USDA and the Department of Justice with the opportunity to comment on a draft of this report. We received written comments from both departments. Both departments suggested that we revise our report to recognize that they do coordinate their activities and share information informally in pursuing improper bid-rigging involving dairy cooperatives. In response to this comment, we revised the report to note that the departments do share information on an informal, ad hoc basis.

USDA commented that it will continue to examine and consider bid-rigging cases for potential suspension and debarment actions in accordance with

FNS' policy, under which it refrains from taking a suspension or debarment action when the cause for such action predates the publication of the debarment regulation. USDA commented that FNS has begun to expand its bid-rigging awareness training to additional jurisdictions and will continue to encourage state agencies to work with local school officials to ensure their understanding of procurement requirements and of bid-rigging issues. USDA also commented on several technical aspects of this report, especially regarding the authority established under the Federal Acquisition Regulation to suspend and debar dairies and individuals.

We revised the report where appropriate and have included detailed responses to the departments' comments in appendixes I and II.

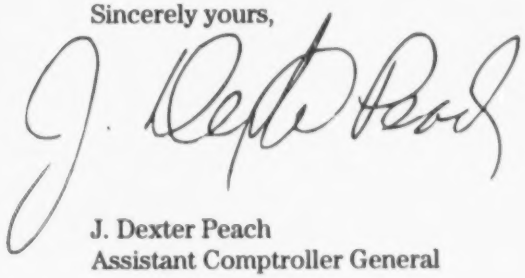
Scope and Methodology

In examining bid-rigging of school milk contracts, we interviewed USDA, DOD, and Department of Justice officials and reviewed their records on bid-rigging cases. We reviewed laws, executive orders, and regulations applicable to antitrust violations, suspension, and debarment. We also drew on historical data on the dairy industry presented in our prior reports. We conducted our review from December 1991 through September 1992 in accordance with generally accepted government auditing standards.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after the date of this letter. At that time, we will send copies to the Secretary of Agriculture and the Attorney General. We also will make copies available to others on request.

This work was conducted under the direction of John W. Harman, Director, Food and Agriculture Issues, who may be reached at (202) 275-5138 if you or your staff have any questions concerning this report. Major contributors to this report are listed in appendix III.

Sincerely yours,



J. Dexter Peach
Assistant Comptroller General

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Abbreviations

DOD	Department of Defense
FNS	Food and Nutrition Service
GAO	General Accounting Office
USDA	U.S. Department of Agriculture

Comments From the U.S. Department of Agriculture

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

United States Department of Agriculture

Food and Nutrition Service

3101 Park Center Drive
Alexandria, VA 22302

SEP 17 1992

John W. Harman
Director
Food and Agriculture Issues
Resources, Community, and
Economic Development Division
General Accounting Office
441 G. Street, NW, Room 4075
Washington, D.C. 20548

Dear Mr. Harman:

Now GAO/RCED-93-5.

This responds to your request to the Secretary of Agriculture for comments on the draft report entitled Food Assistance: School Milk Contract Bid-Rigging (GAO/RCED-92-198). This report examines reasons for the occurrence of bid-rigging on school milk contracts, including the possible influence of the Capper-Volstead Act. The report also presents information on steps that could be taken to assist in detecting, prosecuting, or deterring milk contract bid-rigging.

There are some statements in the draft report which we believe need correction or clarification. The following comments address these areas of disagreement:

Page 2, paragraph 2:

The GAO has concluded that the Department of Agriculture (USDA) has not used "... its contract debarment and suspension authority against dairies either convicted of or under investigation for milk contract bid-rigging." This conclusion, and several similar statements presented in the draft report, require correction prior to publication of the final report.

USDA, through the Food and Nutrition Service (FNS), cannot use its contract debarment and suspension authority against dairies as suggested by the GAO to debar or suspend those offending dairies from participating in Federal non-procurement programs. Contract, or procurement, debarment and suspension authority is established through the Federal Acquisition Regulations (FAR) and covers procurement in which the Federal Government directly contracts with a vendor. The suspension or debarment authority provided under FAR may be used only to debar or suspend entities from Federal procurement actions. For grant programs like the child nutrition programs, FNS does not enter into any contractual relationship with milk producers. All contractual relationships are between FNS program grantees and subgrantees and milk producers. Thus, debarment or suspension

See comment 1.

under FAR would not debar or suspend the entity from the non-procurement child nutrition programs.

On January 30, 1989, USDA published regulation 7 CFR Part 3017 which provided for debarment and suspension actions under grant programs. These actions were termed "non-procurement" to clearly differentiate them from procurement actions taken under FAR. While the procedures and effects of procurement and non-procurement debarment and suspension processes are similar, these represent two separate and distinct systems.

It is correct that FNS has not processed any suspension or debarment actions under FAR against dairy companies, but as noted above, FAR is not applicable. FNS has examined suspension or debarment actions against several dairy companies for bid-rigging and other antitrust violations under Part 3017. However, it is FNS policy to refrain from taking suspension or debarment actions when the cause for such action occurred prior to the public notification of the regulation (i.e., January 30, 1989). In several instances of school milk contract bid-rigging, the causes for a potential suspension or debarment action occurred prior to January 30, 1989, and therefore, FNS refrained from initiating debarment or suspension actions. In all other cases referred to FNS, FNS evaluated the cases for potential action under the non-procurement regulations, but recommended against debarment or suspension. It was the determination of FNS in such cases that other actions (e.g., court settlements) were sufficient to protect the interests of the public and the Federal Government. As required by Part 3017, FNS will take suspension or debarment actions only when it is necessary to protect the interests of the public and the Federal Government; suspension and debarment actions are not, under any circumstances, to be used for punitive purposes.

See comment 2.

Now on pp. 5-7.

Pages 8-9:

The Secretary of Agriculture has delegated authority to the Assistant Secretary for Economics, the Assistant Secretary for Marketing and Inspection Services and the General Counsel to serve as members of the Capper-Volstead Committee to perform the responsibilities of the Secretary under the Capper-Volstead Act. The Committee would like to clarify that there is no indication that cooperatives are working together currently in illegal activity. The activity of cooperatives acting together as described in this report is exempt from the application of the antitrust laws.

See comment 3.

Now on p. 8.

Page 10, paragraph 2 and footnote:

The GAO draft report states: "Under federal procurement regulations, if a company or individual is convicted of bid-rigging, there is a cause for debarment, which would remain in effect for 3 years." FAR is cited as a reference.

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As already noted, FAR has no application to grantee contracts under the child nutrition programs. The correct reference is 7 CFR 3017.320(a), which provides that debarment shall be for a period commensurate with the seriousness of the cause(s). That section further provides that a debarment should not exceed 3 years; however, where circumstances warrant, a longer period of debarment may be imposed.

Now on p. 8.

Page 11, paragraph 1:
It is correct that the Defense Logistics Agency took suspension or debarment actions against several dairy companies under procurement rules. Those actions do not automatically preclude non-procurement transactions under Part 3017. However, separate suspension or debarment proceeding would be required under Part 3017 to effect a non-procurement action. As noted above, FNS does not pursue such actions when the causes for non-procurement suspension or debarment actions occurred before January 30, 1989.

Now on p. 9.

Page 11, paragraph 2:
We do not believe it is correct to say that FNS has not developed expertise in the areas of suspension and debarment. FNS has much experience in this area under FAR. Because the non-procurement system dates only to January 1989, FNS is continuing with the establishment of the infrastructure on the non-procurement side to complement the structure that already exists for procurement suspensions and debarments. We would note that the Department of Defense and the Defense Logistics Agency are also processing actions under procurement rules, not non-procurement rules. Therefore, it would be much more accurate to report that FNS is formalizing the infrastructure to handle non-procurement suspension and debarment investigations and proceedings.

See comment 4.

Now on pp. 7 and 11.

Page 10 and page 14, recommendation 1:
The Capper-Volstead Committee concurs with the report's recommendation that the Secretary of Agriculture and the Attorney General should cooperate and share information on dairy cooperatives suspected of illegal contract bidding activities. An administrative process does exist to allow USDA and the Department of Justice to share information on an informal basis.

See comment 5.

Now on p. 11.

Page 14, recommendation 2:
With regard to individuals and companies convicted or indicted for bid-rigging, the GAO has recommended that USDA debar or suspend such individuals or companies from participating in school milk contracts, or take other appropriate administrative action. FNS will continue to examine and consider such cases for potential suspension or debarment actions. Consistent with FNS policy, FNS will consider the timing for the cause of such actions in relation to the publication date of the rule.

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The Agency will also pursue such actions to the extent that the interests of the public and the Federal Government need to be protected. FNS will not take a suspension or debarment action as a punitive measure.

Recommendation deleted.

Page 14, recommendation 3:

The GAO has also recommended that USDA, in consultation with the Department of Justice, examine the feasibility of offering bid-rigging awareness training to State and local school procurement officials on a nationwide basis. As the GAO reports, FNS initiated training in its Southeast Region, recognizing a need among State and local school food program staff for an awareness of procurement and bid-rigging issues. FNS has begun to expand this training to other jurisdictions. The Agency will continue to encourage State agencies to work with local school officials to ensure their understanding of procurement requirements and of bid-rigging issues.

See comment 6.

In preparing the report for final publication, we would like to suggest that the following technical changes also be made:

Now on p. 2.

(1) Page 3, paragraph 1, third sentence: Clarify background information to read, "Reimbursements are on a fixed per meal or half pint of milk served basis. The schools use these funds, as well as State and local funds and monies collected from students, to purchase food, including milk, and to pay other costs such as labor for these programs."

(2) Page 3, paragraph 2, last sentence: Correct the sentence to indicate, "As of March 30, 1992, bid-rigging prosecutions have resulted in the conviction and sentencing of 13 dairies and 28 individuals."

Now on p. 3.

(3) Page 4, paragraph 1, last sentence: Revise the sentence to read, "These officials stated that...as evidenced by the number of dairies, and their employees, that have been convicted and sentenced."

Now on p. 3.

(4) Page 4, paragraph 4: Clarify the paragraph to read, "The milk marketing order program, created under the Agricultural Marketing Agreement Act of 1937, as amended, (7 U.S.C. 601-674) is administered by USDA. Under this program, USDA establishes minimum prices for milk used in fluid milk products and other dairy products, such as cheese and butter, within a geographical area which is called a marketing order area. Companies that buy milk from dairy farmers supplying the marketing order area are then required to pay farmers at least the USDA minimum prices for their milk. The orders also specify how the returns from

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milk are to be distributed among producers and the terms and conditions of sales."

Now on p. 4.

(5) Page 5, paragraph 2: Revise the paragraph to read, "Price supports, created by the Agricultural Act of 1949 (7 U.S.C. 1421-1449), also administered by USDA, ensure that farmers receive a minimum price and have an alternative market for their products when market prices drop below the support level. Under this program, USDA agrees to buy all cheese, butter, and nonfat dry milk, at announced USDA prices, thus providing a floor for milk and dairy product prices."

Now on p. 8.

(6) Page 10, paragraph 2, last sentence: Clarify the statement to read, "Under Federal procurement regulations...there is a cause for debarment, which, if taken, would remain in effect for 3 years."

Now on p. 8.

(7) Page 11, paragraph 1, last sentence: Restate the sentence to indicate, "Rather than a direct procurement...Federal monies are provided through the State to local school food authorities which, in turn, combine these funds...to serve to students participating in the National School Lunch, School Breakfast, and Special Milk Programs."

Now on p. 9.

(8) Page 11, paragraph 2, third sentence: Revise the statement to read, "According to USDA Food and Nutrition Service (FNS) officials, who manage the school food programs...."

We appreciate this opportunity to comment on the report prior to its final publication. These comments reflect the views of all agencies within USDA which have responsibilities related to the subject matter of this report. We trust that this information clarifies the issues which have been raised in the report.

Sincerely,

for Betty Jo Nelsen
Administrator

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The following are GAO's comments on the U.S. Department of Agriculture's (USDA) letter of September 17, 1992.

GAO's Comments

1. The report has been revised to clarify that separate suspension and debarment regulations govern federal nonprocurement programs—such as USDA's child nutrition programs—and direct federal procurements, although under both, a conviction for bid-rigging is a cause for debarment, which, if imposed, normally would remain in effect for 3 years.

2. To date, none of the bid-rigging cases referred to FNS has resulted in a suspension or debarment by the agency. During our follow-up discussion with FNS officials to clarify USDA's comments on this matter, we were told that there are two principal criteria upon which FNS bases its decisions about whether to pursue suspension or debarment. First, we were told that FNS determines if the cause for possible suspension or debarment action occurred before or after January 30, 1989 (the date that USDA's nonprocurement suspension and debarment regulations were published). As a matter of policy, FNS will refrain from pursuing suspension or debarment if the cause for possible action occurred before that date, according to FNS officials. However, according to USDA officials, there does not appear to be a legal prohibition to using causes occurring before the publication or effective date of USDA's debarment regulation as a basis for debarment or suspension actions.

Second, for cases in which the cause was after that date, FNS reviews the legal proceedings (e.g., court settlements) provided to it from the Department of Justice through USDA's Office of General Counsel to determine if there is cause for debarment and whether independent action by FNS is needed to protect the public interest. In making such a determination, one factor FNS takes into consideration is whether a debarment is in the best interest of the school meal program. If, for example, FNS was to debar the sole dairy serving a local school district, the meal program in that district may not be able to obtain needed dairy products or may have to pay substantially more for the products. Although it is not improper for USDA to consider the potential impact of a suspension or debarment on a program, we believe that USDA must carefully balance the deterrent value of such actions against the possible short-term detrimental impacts they may create for some schools or school districts. We believe that the deterrent value of suspension and debarment actions is only meaningful if those dairies that improperly bid-rig have a

reasonable expectation that, if caught, they will be suspended or debarred from federally funded programs.

3. As noted in our 1990 report (Dairy Cooperatives: Role and Effects of the Capper-Volstead Antitrust Exemption, GAO/RCED-90-186, Sept. 4, 1990) and confirmed during this review, USDA does not actively monitor the pricing by dairy cooperatives, but instead relies upon the Department of Justice, which does not have the responsibility to oversee activities affected by the Capper-Volstead exemption, to identify improper price-fixing between cooperatives. The absence of indications of illegal activity may reflect the inadequacy of oversight of the pricing between cooperatives and not, as suggested in USDA's comments, that improper bid-rigging is not occurring.

4. During our follow-up discussions with FNS officials to clarify USDA's comments, we were told that FNS has no staff, such as investigators or lawyers, dedicated to pursue suspensions or debarments. Although FNS uses the department-level procurement staff to assist in its nonprocurement proceedings, this is of limited usefulness because the procurement staff are not familiar with FNS' nonprocurement programs. USDA stated that FNS has developed expertise in suspensions and debarments related to procurements under the Federal Acquisition Regulation and that the agency is in the process of formalizing its infrastructure to handle investigations and proceedings for suspensions and debarments from nonprocurement programs. However, an FNS official said that any increase in the number of nonprocurement cases referred to the agency could make these cases an unmanageable task.

5. The report has been revised to demonstrate the benefits that we believe can be gained by establishing a more formal, systematic mechanism of coordination and information sharing between the Department of Justice and USDA. We pointed out that each department has information that is not available to the other. The systematic sharing of these information resources could enhance the abilities of both departments in carrying out their respective statutory responsibilities under the antitrust laws and the Capper-Volstead Act.

6. We revised the report to include, as appropriate, USDA's suggested technical revisions.

Comments From the Department of Justice

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

U.S. Department of Justice

Washington, D.C. 20530

SEP - 8 1992

John W. Harman
Director
Food and Agriculture Issues
Resources, Community and Economic
Development Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Harman:

The following information is being provided in response to your request to the Attorney General, dated August 25, 1992, for comments on the General Accounting Office (GAO) draft report entitled, "Food Assistance: School Milk Contract Bid-Rigging." The Department generally agrees with the GAO report. We would like to note, however, that contrary to a statement in the report, there is information sharing between the Departments of Justice and Agriculture (USDA).

Now on p. 1.
Now on p. 10.

Both in the results in brief (page 2) and the conclusion (page 13) in support of its recommendation for greater coordination between the Departments of Justice and Agriculture (USDA), GAO notes a lack of coordination efforts. GAO states:

> "Although the Department of Justice and USDA have responsibilities for overseeing agricultural cooperatives, they currently do not coordinate or share information in pursuing improper bid-rigging activity involving dairy cooperatives."

Reference deleted.

GAO's conclusion seems to be supported, at least in part, by the comment on page 10, that "USDA officials stated that they do not share information [with Justice] now because an administrative process for coordinating between the two departments has not been established." We believe, and USDA representatives verify, that the point of this statement is that there is no formal process for such coordination, not that information is not being shared.

The Antitrust Division has worked closely with USDA in conducting its various dairy investigations and prosecutions. Food and Nutrition Service officials have played a vital role in serving as a liaison with state and local school employees in helping us

gather bid information. The companies under investigation have included dairy cooperatives. The Division also has kept the Office of General Counsel, USDA, fully advised of its prosecutions of dairy companies, including cooperatives. Thus, we do not believe it is accurate to say that the Department and USDA currently do not coordinate or share information in pursuing improper bid-rigging activity involving dairy cooperatives. We would suggest that the report be revised.

We appreciate the opportunity to comment on the draft report and hope that you find our comments both constructive and beneficial.

Sincerely,

Harry H. Flickinger
Assistant Attorney General
for Administration

The following are GAO's comments on the Department of Justice's letter of September 8, 1992.

GAO's Comments

We have revised the report to clarify that coordination and information sharing does occur between the Department of Justice and USDA, on a case-by-case basis, in pursuing improper bid-rigging. The Department of Justice has noted (1) the difficulty, under the Capper-Volstead exemption, in successfully prosecuting improper pricing activity and (2) USDA's responsibility for overseeing activities affected by the Capper-Volstead exemption. As previously stated, we believe that a more extensive sharing of information between the Department of Justice and USDA would enhance both departments' abilities to meet responsibilities under antitrust legislation.

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